

## CREDIT OPINION

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### New Issue

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#### Analyst Contacts

Kenneth R Surgenor +1.214.979.6848  
*Analyst*  
 kenneth.surgenor@moody's.com

Tatiana Killen +1.212.553.2895  
*VP-Senior Analyst*  
 tatiana.killen@moody's.com

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# Unified Govt. of Wyandotte Co./Kansas City, KS

## Update to credit analysis

### Summary

The credit profile of the [Unified Government of Wyandotte County/Kansas City, KS](#) (A1 stable; hereafter "UG") is anticipated to remain stable with maintenance of adequate operating reserves through fiscal 2021 as the UG's management adapts to operational pressures presented by the coronavirus pandemic. The UG's large and growing tax base, favorably located near employment centers in [Johnson County, KS](#) (Aaa stable) and [Kansas City, MO](#) (Aa2 stable), will continue to support the credit profile. The UG's elevated fixed costs comprised of outsized debt and pension burdens in addition to ongoing capital needs associated with citywide deferred maintenance and the sewer enterprise EPA consent decree continue to weigh on the profile.

We regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. We do not see any material immediate credit risks for the UG given the material support provided to local governments via the state's CARES Act funding. However, the situation surrounding coronavirus is rapidly evolving and the longer term impact will depend on both the severity and duration of the crisis. If our view of the credit quality of the UG changes, we will update our opinion at that time.

### Credit strengths

- » Material improvement of operating reserves
- » Large tax base that serves as a regional economic center
- » Strengthened financial policies

### Credit challenges

- » Elevated fixed costs comprised of outsized debt and pension burdens
- » Extensive ongoing capital needs associated with citywide deferred maintenance and sewer EPA consent decree
- » Below average resident income indices

## Rating outlook

The stable outlook reflects conservative financial estimates that indicate modest contraction of operating revenues in fiscal 2020 before recovering in fiscal 2021. The resulting operating deficits in each fiscal year will reduce the UG's fund balance to below 15% of operating revenues by the end of fiscal 2021. However, we note sales tax collections have outperformed the UG's estimates by roughly 18% through May 2020. Continued positive performance is likely to narrow the anticipated deficit spending and result in better than anticipated financial performance.

## Factors that could lead to an upgrade

- » Material mitigation of debt and pension burdens leading to reduction of fixed costs
- » Trend of significantly improved operating reserves

## Factors that could lead to a downgrade

- » Further leveraging of the tax base, either via debt or growth of pension obligations, absent corresponding taxable value growth
- » Contraction of operating reserve beyond current projections
- » Trend of tax base contraction or loss of major taxpayer

## Key indicators

Exhibit 1

### Key Indicators for Unified Govt. of Wyandotte Co./Kansas City,KS

	2015	2016	2017	2018	2019
<b>Economy/Tax Base</b>					
Total Full Value (\$000)	\$7,478,660	\$7,762,145	\$7,994,973	\$8,293,973	\$8,946,180
Population	148,855	149,755	151,042	152,069	165,429
Full Value Per Capita	\$50,241	\$51,832	\$52,932	\$54,541	\$54,079
Median Family Income (% of US Median)	69.0%	68.7%	69.0%	70.0%	70.0%
<b>Finances</b>					
Operating Revenue (\$000)	\$291,290	\$258,854	\$242,850	\$245,768	\$255,707
Fund Balance (\$000)	\$50,756	\$49,025	\$63,320	\$60,249	\$86,896
Cash Balance (\$000)	\$40,282	\$45,216	\$55,431	\$78,054	\$76,981
Fund Balance as a % of Revenues	17.4%	18.9%	26.1%	24.5%	34.0%
Cash Balance as a % of Revenues	13.8%	17.5%	22.8%	31.8%	30.1%
<b>Debt/Pensions</b>					
Net Direct Debt (\$000)	\$543,387	\$568,412	\$595,791	\$659,512	\$626,178
3-Year Average of Moody's ANPL (\$000)	\$628,798	\$455,516	\$454,578	\$475,204	\$485,117
Net Direct Debt / Full Value (%)	7.3%	7.3%	7.5%	8.0%	7.0%
Net Direct Debt / Operating Revenues (x)	1.9x	2.2x	2.5x	2.7x	2.4x
Moody's - ANPL (3-yr average) to Full Value (%)	8.4%	5.9%	5.7%	5.7%	5.4%
Moody's - ANPL (3-yr average) to Revenues (x)	2.2x	1.8x	1.9x	1.9x	1.9x

Source: UG's audited financial statements, US Census Bureau, Moody's Investors Service

## Profile

The Unified Government of Wyandotte County/Kansas City is the state's third largest metro area with an estimated population of 165,324 as of 2019. The government serves as a regional center for manufacturing, transportation, health care and retail.

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## Detailed credit considerations

### Economy and tax base: large, stable tax base serves as regional economic center

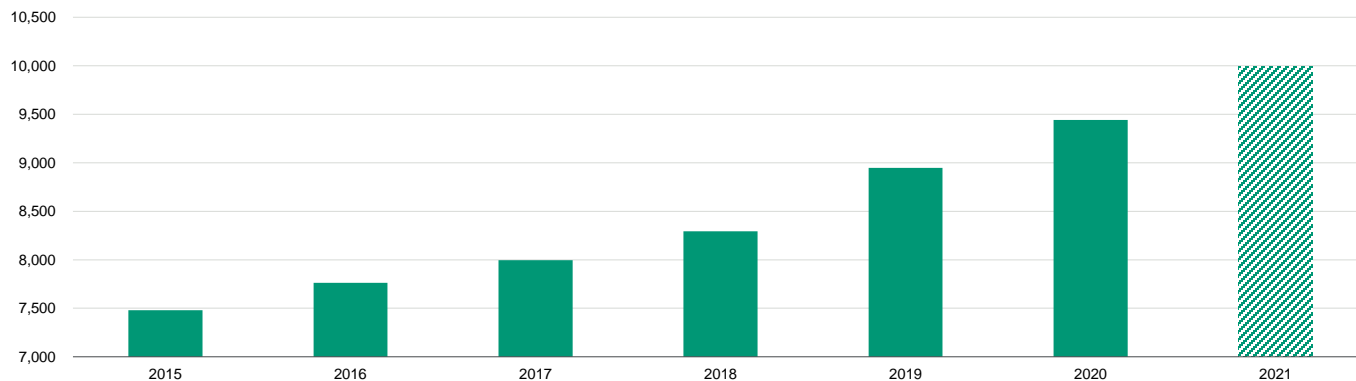
The coronavirus is driving an unprecedented economic slowdown. We currently forecast US GDP to decline significantly during 2020 with a gradual recovery commencing toward the end of the year. Local governments with the highest exposure to tourism, hospitality, healthcare, retail, and oil and gas could suffer particularly severe impacts. The effect on local governments will vary based on the extent and duration of local disruption and could be more or less severe than the nation overall. The evolution of the crisis remains highly uncertain and the full extent of the economic costs will be unclear for some time.

Modest annual expansion of the UG's tax base is expected to continue due to ongoing commercial and residential/multi-family development. Notable economic development expected to come online over the next couple of years include a number of upscale multi-family apartment developments, the new American Royal headquarters located adjacent to the Kansas speedway, a 266,000 square foot state-of-the-art automated warehouse and distribution facility, and improvement to the I-70/Turner Diagonal interchange that will eliminate the offramp loops and free up land for additional development. Retail improvements include a new Menards with a full service lumber yard and a grocery coop constructed by the UG (operated and managed by The Merc, a grocery cooperative operating in the [City of Lawrence, KS](#) (Aa1) since 1974 that will address a food desert in downtown Kansas City. Further development is expected to occur around the site; the store opened in July 2020.

Over the past five years, the tax base has expanded 4.5% on average, including a 5.5% increase for fiscal 2020 to a sizable \$9.4 billion (derived from an assessed valuation of \$1.4 billion); preliminary valuation for fiscal 2021 indicates a 5.8% increase in assessed valuation. The ten largest taxpayers account for an above average 16.8% of assessed value, but are diversified across various sectors, with Legends Shopping Center (2.9% of assessed valuation), General Motors (2.2%), and Kansas Entertainment, LLC (2.0%), a casino development, comprising the largest of the UG's taxpayers.

Exhibit 2

#### Modest tax base expansion anticipated to continue



2021 full valuation is a preliminary estimate based on the preliminary assessed valuation

Source: Government data sources; Moody's Investors Service

Resident income indices in the UG are below average with a median family income equal to 70% of the US, however, the cost of living is commensurate with a median home value equal to 44.7% of the US. Similar to the rest of the nation, the UG's unemployment rate has skyrocketed in response to the coronavirus pandemic and resulting economic shutdown. As of June 2020, the UG's unemployment rate of 10.3% exceeded that state's 7.6% rate, but fared better than the national (11.2%) rate for the same period.

### Finances and liquidity: pandemic to impact revenues through 2021 though reserves anticipated to remain adequate

While we expect the Unified Government's financial position to remain adequate over the near term given materially improved operating performance since the low in fiscal 2014, revenue impacts related to the coronavirus pandemic coupled with reductions in the property tax rate in previous years and increased fixed costs will contribute to a near term contraction of reserves.

In fiscal 2019, the UG's general fund posted a modest \$2.4 million surplus to close the year with \$42.3 million in reserve, representing an adequate 19.8% of general fund revenues. The surplus was attributable to healthy gains in property and sales tax revenues

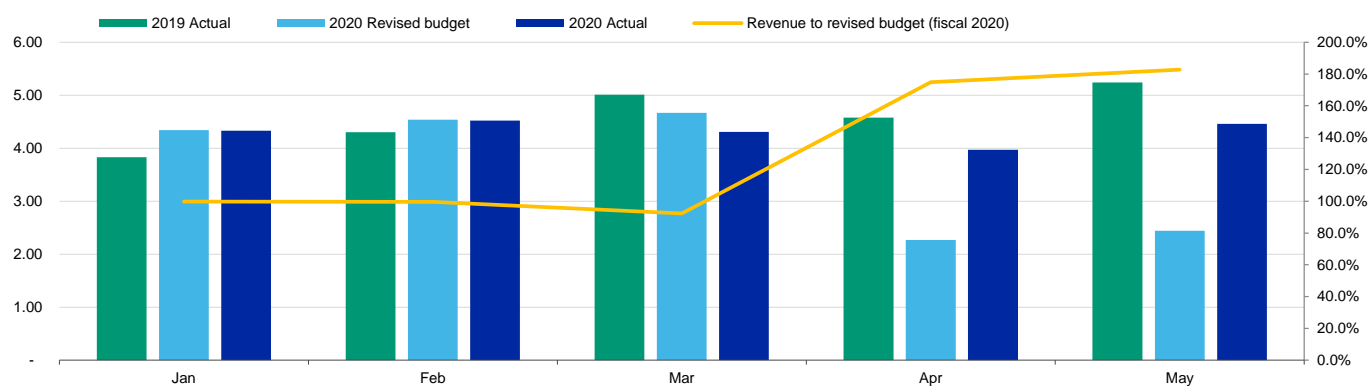
outpacing expenditure growth. The UG's operating funds, comprised of general and debt service funds, posted a smaller \$1.2 million surplus to close the year with \$86.9 million in operating reserves, representing a healthy 34% of operating revenues. While the operating funds report a strong ending position, we note a portion of the economic development debt service funds are unspent bond proceeds.

The UG's revised fiscal 2020 budget anticipates closing with a \$10.9 million deficit driven by sales tax revenue loss and the full funding of budgeted positions. The revised budget includes sales tax revenue loss of 22% relative to fiscal 2019's performance, however, through May's distribution, year over year (YOY) sales tax revenue is only down 6% and is 18% ahead of the revised budget (see Exhibit 2). Additionally, management implemented a hiring freeze (there are currently approximately 300 vacant positions) and deferred some capital spending that will help offset the anticipated revenue loss. Still, the revised budget calls for reserves to decline to around 15% of expenditures, below the UG's target to maintain 17%.

The adopted fiscal 2021 budget indicates further contraction in fiscal 2021, though we note the fiscal 2021 budget was crafted with limited insight into sales tax performance given the 60 day lag between collection and distribution. The fiscal 2021 budget is also fairly conservative as Kansas state law requires cities adopt the budget in August despite the fact that the UG is only 50% through their fiscal year at adoption. Given the volatility and uncertainty surrounding the coronavirus pandemic, fiscal 2021's financial performance is likely to materially vary from the adopted budget.

Exhibit 3

### Sales tax revenue performing better than the revised budget anticipated



Source: Unified Government

### Liquidity

The Unified Government closed fiscal 2019 with \$77 million in operating cash and investments, representing 30.1% of operating revenues.

### Debt and pensions: elevated fixed costs to remain; debt burden high relative to peers

The UG's debt burden is expected to remain high, though manageable, given significant enterprise support and ongoing new money issuance to meet capital needs. Post issuance, the UG's gross debt burden of 7.8% of fiscal 2020 full valuation (12.6% overall inclusive of overlapping debt) is well above peers. However, the UG has allocated approximately \$123.3 million of GOULT debt and \$23.6 million of Temporary Notes to the sanitary sewer system and intends to satisfy these obligations with excess revenues of the system. Exclusive of enterprise supported debt and self-supporting sales tax revenue debt, the UG's net direct debt burden falls to a more manageable, though still elevated, 5.9% of full value. Moody's notes that none of the outstanding sales tax debt with an appropriation pledge has required non-sales tax support to meet debt service requirements. Pressures on these revenues which necessitate support from the government for debt service could stress its financial position. Looking ahead, the Unified Government expects to issue \$13-15 million in GOULT debt annually to fund various capital projects.

### Legal security

The Series 2020-B/C GOULT bonds are general obligations of the Unified Government payable as to both principal and interest from ad valorem taxes which may be levied without limitation as to rate or amount upon all the taxable tangible property, real and personal,

within the territorial limits of the UG, excluding the incorporated areas of Bonner Springs, Edwardsville, and Lake Quivira, and excluding the unincorporated area of the UG. The full faith, credit and resources of the UG are irrevocably pledged for the prompt payment of the principal and interest on the bonds.

The Series 2020-D bonds are special obligations of the Unified Government subject to and dependent on annual appropriations made by the Commission. The UG is not obligated to levy or pledge any form of taxation or make any appropriation or payments beyond those appropriated for the then current fiscal year.

#### **Debt structure**

All of the UG's debt is fixed rate and matures over the long term (exclusive of Temp Notes that mature in March 2021); final maturity on long-term debt occurs in 2040. Principal amortization is below average with 59.7% of the long-term GO debt repaid within ten years.

#### **Debt-related derivatives**

The Unified Government is not party to any interest rate swaps or other derivative agreements.

#### **Pensions and OPEB**

Fixed costs are expected to remain manageable over the near term, though the pension plans high discount rate is likely to require increasing contributions. The Unified Government participates in two statewide cost-sharing defined benefit pension plans, the Kansas Public Employees Retirement System (KPERs) and Kansas Police and Fireman's Retirement System (KP&F). The UG has consistently made its required contributions to the plan in accordance with statutory requirements.

Moody's three year average adjusted net pension liability (ANPL) for the UG is \$485.1 million, or 1.9 times fiscal 2019 operating revenues (general and debt service funds) and 5.4% of full value. Contributions to the plan were approximately \$19.2 million, or a manageable 7.5% of operating revenues. Fiscal 2019 fixed costs were approximately \$66 million (\$45.4 million in debt service, \$19.2 million in pension contributions, and \$1.3 million in OPEB contributions), representing an elevated 25.8% of operating revenues. Operating revenue loss in fiscal 2020 and 2021 will drive this percentage higher, though we expect the burden to remain manageable. The UG's pension contributions were above "tread water" in fiscal 2019 by approximately \$2 million, representing less than 1% of operating revenues.

We determined the city's share of liability for the cost-sharing plans administered under KPERs in proportion to its contributions to the plan. The "tread water" indicator measures the annual government contribution required to prevent the reported NPL from growing, under reported assumptions. Contributions above this level cover all NPL interest plus pay down some principal, making them stronger from a credit perspective than contributions below this level. We expect that the city will adequately incorporate rising pension costs into its budget while maintaining operational balance.

## **ESG considerations**

### **Environmental**

Environmental considerations do not present material risks to the county's credit profile. The county's location in eastern [Kansas](#) (Aa2 stable), along the border with [Missouri](#) (Aaa stable), puts it at high and medium risk for heat and extreme rainfall, respectively. Extreme weather events are also typically accompanied by state and federal assistance, which further mitigates environmental risk.

### **Social**

Please see the "Economy and tax base" section above for detail on social considerations.

### **Governance**

The Unified Government is governed by a the Mayor, who serves as the Chief Executive, and a ten member Board of Commissioners. Each of eight districts nominates and elects one commissioner. Two at-large commissioners are nominated and elected from two countywide districts comprised of the four northern-most and four southern-most districts. A county administrator is responsible for the day to day operations of the UG.

Kansas counties have an institutional framework score of "Aaa," which is very strong compared to the nation. Counties rely heavily on property tax revenues, which are highly predictable. Local option sales taxes are a smaller revenue source. Counties enjoy a strong

ability to increase property taxes without limit. In 2018, a new state law will limit property tax revenue increases without voter approval, though the legislation includes numerous exemptions, resulting in a moderate revenue-raising ability. Expenditures mostly consist of public safety, which are highly predictable. Counties have a high ability to reduce major expenditures given the lack of collective bargaining units in most of the state.

## Rating methodology and scorecard factors

The [US Local Government General Obligation Debt](#) methodology includes a scorecard, a tool providing a composite score of a local government's credit profile based on the weighted factors we consider most important, universal and measurable, as well as possible notching adjustments dependent on individual credit strengths and weaknesses. Its purpose is not to determine the final rating, but rather to provide a standard platform from which to analyze and compare local government credits.

Exhibit 4

### Unified Government of Wyandotte Co./Kansas City, KS

Scorecard Factors	Measure	Score
Economy/Tax Base (30%) <sup>[1]</sup>		
Tax Base Size: Full Value (in 000s)	\$9,440,555	Aa
Full Value Per Capita	\$57,067	A
Median Family Income (% of US Median)	70.0%	Baa
Finances (30%)		
Fund Balance as a % of Revenues	34.0%	Aaa
5-Year Dollar Change in Fund Balance as % of Revenues	26.7%	Aaa
Cash Balance as a % of Revenues	30.1%	Aaa
5-Year Dollar Change in Cash Balance as % of Revenues	19.5%	Aa
Notching Adjustments: <sup>[2]</sup>		
Other Scorecard Adjustment Related to Finances:		Down
Management (20%)		
Institutional Framework	Aaa	Aaa
Operating History: 5-Year Average of Operating Revenues / Operating Expenditures (x)	1.0x	A
Debt and Pensions (20%)		
Net Direct Debt / Full Value (%)	7.8%	Baa
Net Direct Debt / Operating Revenues (x)	2.9x	A
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value (%)	5.1%	Baa
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues (x)	1.9x	A
Notching Adjustments: <sup>[2]</sup>		
Other Scorecard Adjustment Related to Debt and Pensions:		Down
	Scorecard-Indicated Outcome	A1
	Assigned Rating	A1

[1] Economy measures are based on data from the most recent year available.

[2] Notching Factors are specifically defined in the US Local Government General Obligation Debt methodology.

[3] Standardized adjustments are outlined in the GO Methodology Scorecard Inputs publication.

Source: UG's audited financial statements, US Census Bureau, Moody's Investors Service

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